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RUEHBK/AMEMBASSY BANGKOK 3495  
RUEHBJ/AMEMBASSY BEIJING 6008  
RUEHUL/AMEMBASSY SEOUL 8289  
RUEHGP/AMEMBASSY SINGAPORE 6702  
RUEHKO/AMEMBASSY TOKYO 8257  
RUEHML/AMEMBASSY MANILA 9855  
RUEHJA/AMEMBASSY JAKARTA 3955  
RUEHKL/AMEMBASSY KUALA LUMPUR 3604  
RUEHHI/AMEMBASSY HANOI 3170  
RUEHBY/AMEMBASSY CANBERRA 4383  
RUEHWL/AMEMBASSY WELLINGTON 1631  
RUEHHK/AMCONSUL HONG KONG 7232  
RUEHGH/AMCONSUL SHANGHAI 0581  
RUEHGZ/AMCONSUL GUANGZHOU 9764

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STATE PLEASE PASS USTR  
STATE FOR EAP/RSP/TC, EAP/EP  
USTR FOR ALTBACH  
USDOC FOR 3132/USFCS/OIO/EAP/WZARIT  
TREASURY FOR OASIA/LMOGHTADER  
TREASURY PLEASE PASS TO OCC/AMCMAHON  
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF  
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

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SUBJECT: Trade Performance Better Than Expected

#### SUMMARY

1. Taiwan's trade in Q3 this year was better than predicted, with both exports and imports growing faster than previously estimated by think tanks. Higher export growth and a larger trade surplus should lead to upward adjustment of Taiwan's 2006 economic growth. High-tech industries, the backbone of Taiwan's manufacturing sector, enjoyed brisk export sales which, in turn, have contributed to growth in capital goods imports and double-digit growth in imports of other production inputs in Q3.

2. Strong U.S. demand for Taiwan's electronic goods has driven up growth in exports to the United States. With regional economic integration, Greater China (including Hong Kong) took 40% of Taiwan's exports and supplied 13% of Taiwan's imports, only after Japan's share of 23%. Regional economic integration has also contributed to double-digit growth in exports to and imports from ASEAN whose importance in trade to Taiwan has surpassed that of the European Union. Higher oil prices prompted imports from three oil exporting countries to post 26-76% growth. END SUMMARY.

#### Export Growth and Trade Surplus Higher Than Expected

3. Based on Taiwan customs clearance statistics, exports in the first nine months this year grew 15% from a year ago to US\$165 billion while imports rose 11.4% to US\$151.4 billion, leaving a trade surplus of US\$13.6 billion, 76% above the same period of last year. The y-o-y export growth accelerated from 12% in Q1 to 18.6% in Q3, a new high in the past two years. Import growth also increased from 9% in Q1 to 15% in Q3, the highest in the past 21 months.

¶4. Taiwan's exports in Q3 this year totaled US\$59 billion, up 18.6% from a year ago and higher than the 12.3% previously estimated by Taiwan's Statistical Bureau (SB) and the 7-8% predicted by two private think tanks. Meanwhile, Taiwan's imports in Q3 were US\$53.2 billion, registering a growth of 15%, higher than the 9-10% estimated by the SB and other think tanks. Taiwan's trade surplus in Q3 more than tripled a year ago to US\$5.8 billion which was 25% higher than the US\$4.7 billion estimated by the SB.

#### Composition of Exports

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¶5. Exports were mainly such electronic, electrical, and optical products as chips, wafers, integrated circuits, printed circuit boards, liquid crystal displays, color monitors, and mobile phones. These high-tech products and other capital-intensive goods accounted for over 80% of Taiwan's total exports in the first nine months this year. During the period, high tech products enjoyed exceptional export growth, including 44% for optical devices, 28% for electronics, and 18% for electrical products. Higher international prices of iron, steel and other metals since the middle of this year have also driven up growth in Taiwan's exports of basic metal products from 1.6% in the first half of this year to 34% in Q3.

#### Composition of Imports

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¶6. Taiwan's imports were principally production inputs. Energy, materials, and semi-finished goods constituted three-quarters of Taiwan's total imports. This category's import growth has accelerated from 16% in Q1 to 18% in Q3. Higher international oil prices have driven up Taiwan's crude oil imports which registered a y-o-y growth of 40% in the first nine months this year. During the

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nine-month period, crude oil accounted for 12% of Taiwan's total imports, up from 7.5% two years ago. Consequently, Taiwan's imports from oil producing countries posted very high growth, including 76% from United Arab Emirates, 43% from Saudi Arabia, and 26% from Kuwait.

#### Surge in Imports of U.S. Capital Goods

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¶7. Capital goods accounted for 17% of Taiwan's total imports. Imports of machinery and equipment (including silicon wafer fabricating facilities) showed y-o-y growth of 8% in Q3, up from declines in the past four consecutive quarters. As the United States is a major source of capital goods, imports from the United States in Q3 surged by 19% from a year ago, much higher than the 4% growth in imports from Japan and the 0.2% decline in imports from the EU.

¶8. Consumer goods accounted for only 7.8% of Taiwan's total imports. Delinquent credit/cash card debt problems have dampened private consumption and caused imports of consumer goods in the first nine months to level off to US\$1.3 billion.

#### Trade with USA Expands

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¶9. Based on trade statistics for the first nine months this year, the United States was Taiwan's third largest trading partner, second largest export market, and third largest source of imports.

¶10. Defying higher interest rates in the United States, Taiwan's trade with the United States in the first nine months this year expanded, particularly in Q3. Exports to the United States increased 14% from a year ago to US\$24.4 billion. Imports from the United States rose 3.3% to US\$16.6 billion. Strong U.S. demand for Taiwan's chips, wafers, integrated circuits, crystal display devices and other electronic and optical devices and parts has caused growth in Taiwan's exports to the United States to accelerate from 7.4% in Q1 to 20.1% in Q3.

¶11. Taiwan high-tech industries started expanding production

capacity in the second half of this year, and the United States has been a major source of the needed equipment. Consequently, imports from the United States, registering a decline of 4% in Q1 and another decline of 3.4% in Q2, switched to an increase of 18.6% in Q3 when imports from Japan inched up only 4% and imports from EU declined 0.2%.

#### China Still Taiwan's Top Trading Partner

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¶12. Due to cross-Straits economic integration over the past decade, Greater China has exceeded the United States and Japan to become Taiwan's top trading partner. It is Taiwan's largest export market and second largest source of imports, only after Japan. In addition, Taiwan has a large trade surplus with Greater China. In the first nine months this year, Taiwan's exports to Greater China grew 17% from a year ago to US\$65.3 billion, while its imports surged 20% to US\$19.4 billion. Taiwan's trade surplus increased 16% to US\$46 billion, more than triple Taiwan's trade surplus with world.

¶13. Exports to Greater China in the first nine months this year accounted for 40% of Taiwan's total exports, up steadily from 12.7% in 1990. Over 80% of Taiwan's exports to Greater China are production inputs which are processed into finished goods mainly for export from China to such developed nations as the United States,

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Europe, and Japan. A growing share of the goods finished in China is shipped back to Taiwan.

¶14. Imports from Greater China in the first nine months this year occupied 12.8% of Taiwan's total imports, compared to three percent in 1990. Imports from China are basically finished goods, electronic and electronic components requiring lower technologies, coals, and other materials.

#### Japan Is Taiwan's Second Largest Trading Partner

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¶15. In the first nine months this year, Japan remained Taiwan's second largest trading partner, after Greater China. Japan was Taiwan's largest source of imports and third largest export market. Taiwan has had a trade deficit with Japan. During the first nine months this year, exports to Japan rose nine percent from a year ago to US\$12 billion, while imports from Japan leveled off to US\$34.7 billion. Taiwan's trade deficit with Japan shrank 5% to US\$22.6 billion.

¶16. As many Taiwan business firms have relocated their production bases to China, exports directly from Taiwan to Japan as a percentage of Taiwan's total exports in the first nine months this year dropped to 7.3% from 12.5% in 1990. The share of exports to the United States has also plunged from 32% to 14.8% during this period.

¶17. Japan remains Taiwan's main source of imports. However, Japan and the European Union did not benefit much from Taiwan high-tech firms' recent capacity expansion spending spree.

#### Regional Economic Integration Favors ASEAN than EU

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¶18. Taiwan remains a major source of foreign direct investment in Southeast Asia. Taiwan's exports to ASEAN in the first nine months this year grew 18% to US\$22.9 billion, and its imports from ASEAN increased 15% to US\$17.7 billion. During the period, ASEAN took 14% of Taiwan's total exports, exceeding the EU's share of 10.6%. Meanwhile, ASEAN supplied 11.7% of Taiwan's imports, higher than the EU's share of 8.7%. In 1990 ASEAN took 10% of Taiwan's exports and supplied 7.8% of Taiwan's imports, both less than the EU's respective 16.3% and 12.2% shares.

Comment

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¶19. Taiwan's export growth and trade surplus in Q3 were both higher than previously projected. Region economic integration is rapidly proceeding, and Taiwan's bilateral trade integration with Greater China and ASEAN will grow while the relative importance of trade with the EU and United States declines.

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